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October 11, 1996

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Via Federal Express
Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

Re: Ex Parte Supplement Regarding Affiliation Standards by the Small Cable Business Association; CS Docket No. 96-85

Dear Mr. Caton:

We enclose for filing an original and 14 copies of the Ex Parte Supplement by the Small Cable Business Association in the above-referenced matter. Also enclosed is a copy to date-stamp and return in the pre-addressed Federal Express envelope.

Very truly yours,

Howard & Howard

Eric E. Breisach

EEB:cm
Enclosures
cc: David Kinley
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Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996	)	CS Docket No. 96-85
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EX PARTE SUPPLEMENT REGARDING AFFILIATION STANDARDS BY THE SMALL CABLE BUSINESS ASSOCIATION

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Attorneys for the
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October 11, 1996

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SUMMARY

Congress mandated that the Commission place a limit on the size of companies that may benefit from small operator status under the Telecommunications Act of 1996. When establishing the disqualifying affiliation threshold, the Commission must effectuate the intent of Congress to provide greater deregulation for small cable. The Commission must carefully define the relational elements that will give rise to an affiliation.

In Comments and Reply Comments, the Small Cable Business Association ("SCBA") has highlighted the inappropriateness of the proposed standard. SCBA has already shown the stark contrast between the proposed standard and the Commission's own affiliation rules involving certain broadcast interests[1] and broadband PCS providers.[2] SCBA has previously suggested close examination and possible adoption of the Small Business Administration ("SBA") affiliation standards.[3] SCBA prepared this analysis to further highlight the disparity between the Commission's broad and over-inclusive proposal and the carefully crafted regulations developed by SBA.

While both the Commission's proposal and SBA regulations focus on the ability to control an entity, the similarities end there. SBA regulations contrast sharply with the Commission's 20% equity threshold:

- SBA regulations generally use a minimum 50% threshold to trigger a presumption of affiliation. The Commission proposes only a 20% equity threshold.
- SBA regulations differentiate between active and passive interests. The Commission's proposal does not.

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[1]SCBA *Reply Comments* at 6.

[2]SCBA *Comments* at 18.

[3]SCBA *Comments* at 17 - 18.

- SBA exempts nonvoting stock from any consideration of equity ownership. The Commission's proposal does not.

- SBA exempts equity ownership by certain classes of investors (e.g., investment companies and not for profits) from giving rise to affiliations. The Commission's proposal does not.

- SBA regulations allow for temporary control by an investor in specified circumstances such as action to protect an investment, without giving rise to an affiliation. The Commission's proposal does not.

The SBA regulations cited in this analysis demonstrate how carefully considered affiliation standards can effectively restrict the availability of benefits only to companies that legitimately meet articulated size standards.[4] The Commission's proposal aims at the same objective. It will miss, however, because it will exclude many small operators. The Commission must modify its proposal to reflect the realities of small cable ownership and financing. Failure to do so risks saddling small cable with onerous and unwarranted burdens.

[4]SBA size standard regulations typically determine a company's eligibility for participation in SBA programs based on the amount of gross annual revenues or the number of employees.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of	)	
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Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996	)	CS Docket No. 96-85
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EX PARTE SUPPLEMENT REGARDING AFFILIATION STANDARDS BY THE SMALL CABLE BUSINESS ASSOCIATION

I. INTRODUCTION AND BACKGROUND

SCBA submits supplemental information in this docket to assist the Commission in its determination of small cable affiliation definitions. The Commission's proposal threatens to undermine the availability of the deregulatory benefits intended by Congress by severely limiting the number of small cable operators that can meet the Commission's definitions. SCBA provides a detailed comparison of the Commission's proposal to the carefully crafted regulations used by SBA to identify the existence of affiliations for purposes of determining compliance with size standards.

II. THE AFFILIATION STANDARD WILL AFFECT MANY SMALL CABLE ENTITIES

The Commission's affiliation proposal will have a significant adverse impact on many small operators now and many more in the future. Quantification is problematic.[5] Nevertheless, SCBA

[5]No published source identifies the equity participants in small cable. Most arrangements are privately placed.

knows of many members who currently have relationships with investors that would cause them to lose deregulatory protection under the Commission's standards, but not under SBA's regulations. More important, to raise capital, many small cable companies must seek out institutional investors, resulting in relationships that will disqualify operators from deregulatory treatment. This deterrent to capital attraction will hinder small cable's ability to effectively compete in the rapidly advancing telecommunications market. It will also relegate much of rural America served by small cable to a lower quality of service because their providers cannot access necessary capital.

The 1996 Kagan Financial Databook provides an indication of nonqualifying sources of capital. Of the approximately 120 investors and financiers of cable operators that disclosed financial data, approximately 78% disclosed financial information that reports or suggests revenues that exceeded $250 million annually.[6] This 78% represents a significant portion of the capital market for small cable. The Commission must carefully evaluate its proposal before slamming the door on more than three quarters of the capital market for all small operators.

III. THE AFFILIATION STANDARD MUST IDENTIFY ONLY RELATIONSHIPS WHERE CONTROL EXISTS

A. The Commission's proposes an artificially low threshold.

The Commission's test establishes an artificially low numeric threshold to conclusively establish that the ability to control exists.[7] The Commission proposes that any relationship above a

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[6]1996 Kagan Cable TV Financial Databook at 120-151.

[7]In the Matter of Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, *Notice of Proposed Rulemaking*, CS Docket No. 96-85 (released April 9, 1996) ("*NPRM*") at ¶ 83. The Commission suggests that the ultimate determination of what constitutes an affiliation rests on the presence of control. ("De facto control also would constitute affiliation.")

20% equity interest constitutes control.[8] The standard's failure to consider the economic substance of a relationship between investor and a small cable company conflicts with established principles of affiliation that seek to determine whether "control" exists. These include the Commission's own standards as well as the affiliation regulations of SBA.

Congress imposed the affiliation standard to avoid a concentration of media power in certain companies resulting from cross-ownership by an owner involved in the day to day operations of the business.[9] Congress also sought to prevent conferring benefits on large companies through their affiliation with small companies. The ability of an investor to become involved in the day to day operations of the cable company depends solely on the investor's ability to exercise "control."

B. The U.S. Small Business Administration's Regulations Identify Relationships That Constitute "Control."

SBA limits the availability of its programs to businesses that it defines as "small." To ensure that small businesses fronting for large businesses do not receive program benefits, SBA requires these entities to aggregate the size attributes (i.e., either annual revenues or number of employees) of all affiliates.[10] SBA uses the existence of control to determine that an affiliation exists:

> Concerns are affiliates of each other when one concern controls or has the power to control the other, or a third party or parties controls or has the power to control both.[11]

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[8] *NPRM* at ¶ 26. ("Therefore, an entity shall be deemed affiliated with a small cable operator if that entity has a 20% or greater equity interest in the operator (active or passive) or holds de jure or de facto control over the operator.")

[9] SCBA Comments at 13 and n. 25.

[10] 13 C.F.R. § 121.103(4).

[11] 13 C.F.R. § 121.103.

SBA uses a number of standards to determine the existence of control. While some levels of certain types of equity ownership will trigger affiliation, SBA incorporates numerous special provisions that allow substantially higher levels of equity ownership.

C. Unlike the Commission's Rigid and Low 20% Threshold, SBA Examines the Economic Underpinnings of the Relationship and Uses a Number of Tests.

SBA does not employ a singular test to determine whether an affiliation exits. Rather, SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships.[12]

1. SBA Looks to Voting Stock Ownership Percentage as A First Indication of Affiliation.

a. SBA Uses a General 50% Standard.

SBA regulations first examine the percentage of voting equity held by one party. SBA regulations generally establish the affiliation threshold at 50%:

> A person is an affiliate of a concern if the person owns or controls, or has the power to control 50 percent or more of its voting stock. . . .[13]

This initial threshold provides a more realistic measure of small company control than does the Commission's proposed 20% threshold. SBA regulations provide guidance on special circumstances that may warrant a threshold below 50%.

b. SBA Uses a Lower Threshold Only for Special Circumstances.

SBA regulations recognize that circumstances can exist where an owner with less than a 50% equity interest may still possess the ability to exercise control:

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[12] 13 C.F.R. § 121.103(a)(2).

[13] 13 C.F.R. § 121.103(c)(1).

(1) **Large Blocks of Stock.** SBA regulations will find control where an owner of a block of stock can exercise control because the block is large compared to other outstanding blocks.[14]

(2) **Multiple Blocks of Stock of Equivalent Size.** Similarly, where two or more owners hold or control minority interests that are approximately equal in size, SBA regulations find control where the aggregate of the owners' holdings is large compared with any other stock holding.

2. SBA Regulations Exclude Passive Interests From the Affiliation Definition.

SCBA[15] and other commentors have strongly objected to the Commission's proposal to include passive investment interests to determine the existence of affiliations. SCBA has set forth strong policy arguments for excluding these interests. SCBA provides a more detailed analysis of the SBA regulations it previously cited in its Comments.[16] Those regulations exclude all types of passive interests from the determination of an affiliation.

[14]13 C.F.R. § 121.103(c)(1).

[15]SCBA *Comments* at 13-19 and *Reply Comments* at 2-3.

[16]SCBA *Comments* at 17-18.

a. SBA Ownership Thresholds Exclude Passive Interests.

SBA regulations distinguish between sources of capital and control of entity. SBA bases all of its stock ownership tests, including the 50% test, solely on the basis of an entity's ***voting*** stock.[17] The test considering the ability of disproportionately large minority blocks to control also looks solely to the percentage of ***voting*** stock held.[18] Under theses tests, the SBA regulations would not find an affiliation even if 99% of the equity were held by a single individual who held only nonvoting stock. SBA regulations find affiliations only where control exists.

b. SBA Excludes Certain Investors Including Registered Investment Companies From Affiliation Ownership Computations.

SBA has recognized that certain types of investors may own significant equity interests, including voting interests, without giving rise to an affiliation. For example, for financial, management or technical assistance under the Small Business Investment Company program, an applicant is not affiliated with the investors who qualify as:

(1) **Venture capital operating companies** as defined in the U.S. Department of Labor regulations;[19]

(2) **Employee benefit or pension plans** established by the Federal government or any state, or their political

[17] 13 C.F.R. §121.103(c)(1).

[18] 13 C.F.R. § 121.103(c)(2).

[19] 13 C.F.R. §121.103(b)(5)(I).

subdivisions, or any agency or instrumentality thereof, for the benefit of employees;[20]

(3) **Employee benefit or pension plans** within the meaning of the Employee Retirement Income Security Act of 1974;[21]

(4) **Charitable trusts**, foundations, endowments, or similar organizations under section 501(c) of the Internal Revenue Code of 1986;[22]

(5) **Registered investment companies** registered under the Investment Company Act of 1940;[23] and

(6) **Unregistered investment companies** under the Investment Company Act of 1940.[24]

These relationships will not give rise to affiliations because, even though one investor holds a sufficiently large interest, it either cannot or chooses not to exercise control. Many small cable operators obtain capital from institutional investors who seek avenues to convert cash reserves into productive assets, rather than buy their way into management of these entities.

Most institutional investors do not become actively involved in the day to day operations of the businesses in which they invest. For example, money managers for large retirement funds have

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[20] 13 C.F.R. §121.103(b)(5)(ii).

[21] 13 C.F.R. §121.103(b)(5)(iii).

[22] 13 C.F.R. §121.103(b)(5)(iv).

[23] 13 C.F.R. §121.103(b)(5)(v).

[24] 13 C.F.R. §121.103(b)(5)(iv).

a singular goal -- maximize the value of their fund's assets. They simply do not desire to become intertwined with management decision making. Other sources of capital, such as investment companies under the Investment Company Act of 1940, because of their pooling of funds for investors and because of legal prohibitions simply cannot exercise control over a company in which it invests.[25] SBA regulations exempt these relationships. The Commission's affiliation standards should also.

3. SBA Regulations Look Beyond Traditional Indicia of Control to Exempt Certain Relationships From Creating Affiliations.

SBA regulations provide a number of exceptions to presumptions of control. Although other affiliation tests may suggest an affiliation exists, SBA regulations recognize that where management has significant ownership or the exercise of control occurs only temporarily, an affiliation does not exist.

a. Significant Management Ownership.

Significant, but not necessarily controlling, management ownership and management influence on board of directors selection, will defeat a presumption that an affiliation exists. The presumption of affiliation can be overcome if management of a small business owns at least 25% of the outstanding voting securities[26] and can control the election of at least 40% of the board members of a corporation (general partners of a limited partnership, or managers of a limited liability company) with the investor group able to elect no more than 40% of the board members.[27] The balance of the board may be

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[25]SCBA *Reply Comments* at 8.

[26]13 C.F.R. § 107.865(c)(1).

[27]13 C.F.R. § 107.865(c)(2).

elected through mutual agreement between management and the investor group.[28] The Commission's proposal has no similar exception for management ownership and board influence.

b. Temporary Control Permitted.

The maximum "control" many institutional investors may exercise arises when they must take action to protect their investments. SBA has recognized a series of protections most investors require. Under SBA's regulations, the exercise of these protections does not create an affiliation. Either the ability to exercise or the actual exercise of temporary control will not give rise to an affiliation in the following circumstances:

(1) Necessary to protect an investment.[29]

(2) Occurrence of a material breach of the financing agreement;[30]

(3) Substantial change in operations or products;[31] or

(4) One investor provides a major source of capital for start-up business.[32]

Even where a cable operator obtains funds from a passive investor, the operator might typically have to relinquish temporary control if the investment appears at risk. This most frequently happens where the operator fails to meet the objectives outlined in its business plan. Frequently,

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[28] *Id.*

[29] 13 C.F.R. § 107.865(d)(1).

[30] 13 C.F.R. §107.865(d)(2).

[31] 13 C.F.R. §107.865(d)(3).

[32] 13 C.F.R. §107.865(d)(4).

failure to meet business plan goals will also result in a breach of one or more financial covenants of the financing agreement. The SBA regulations for certain business relationships allow these typical elements of control or potential control to exist without giving rise to an affiliation.

Similarly, many small companies attempting to enter the cable business or incumbent operators desiring to expand the numbers of subscribers they serve will typically obtain capital from a single investor. This investor may demand establishment of significant business goals and may require oversight for a period of time, at least until the operator establishes a track record of meeting is performance goals. Again, SBA regulations envision these relationships and specifically recognize that they do not establish an affiliation on their own.

D. The Commission's Proposed Affiliation Standard Fails to Consider Key Relational Elements Incorporated In SBA Standards.

The Commission approaches the affiliation definition with a broad brush in stark contrast to the finely detailed picture of affiliation painted by the SBA regulations. The Commission proposes that an affiliation should exist where *de facto* control exists or where an owner holds more than a 20% equity interest in an entity.[33] SBA regulations, on the other hand raises this initial bar to 50%.

The Commission proposes using any equity interest as a potential indicator of control. This proposal overlooks the fact that many institutional investors hold no right to participate in management or have a voice on the board of directors. SBA regulations consider this by excluding nonvoting stock interests from affiliation tests. Under SBA regulations, an investor supplying 99% of outstanding capital might hold nonvoting stock. Because of the structural inability of the investor to exercise control, SBA regulations will not find an affiliation.

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[33] *NPRM* at ¶ 26.

Even where an investor holds voting stock, certain types of investors that cannot or typically do not exercise control are not considered to give rise to an affiliation. These include investment companies under the Investment Advisor Act of 1940 and certain not for profit investors, including foundations. The Commission's proposal makes no similar accommodations for these oft occurring relationships.

Most types of investor/operator relationships will include a component allowing the investor to exercise some extent of control to protect its investment upon the occurrence of adverse events. SBA considers these realities and exempts them from triggering the existence of an affiliation by themselves. The Commission's proposal fails to consider any of these oft occurring relationships.

IV. CONCLUSION

SCBA strongly urges the Commission to align its affiliation standard with the model provided by the SBA regulations. Failure to do so will result in an unrealistic and harsh affiliation standard that will severely restrict small cable's access to capital markets for reasons completely at odds with Congressional intent. The Commission's proposal is also in direct conflict with the affiliation standards of SBA. For these reasons, the Commission must overhaul its proposed affiliation standard.

Respectfully submitted,

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October 11, 1996

EXHIBIT A

Small Business Administration
Regulation Excerpt

13 C.F.R. § 121.103

§ 121.102 How does SBA establish size standards?

(a) SBA considers economic characteristics comprising the structure of an industry, including degree of competition, average firm size, start-up costs and entry barriers, and distribution of firms by size. It also considers technological changes, competition from other industries, growth trends, historical activity within an industry, unique factors occurring in the industry which may distinguish small firms from other firms, and the objectives of its programs and the impact on those programs of different size standard levels.

(b) As part of its review of a size standard, SBA will investigate if any concern at or below a particular standard would be dominant in the industry. SBA will take into consideration market share of a concern and other appropriate factors which may allow a concern to exercise a major controlling influence on a national basis in which a number of business concerns are engaged. Size standards seek to ensure that a concern that meets a specific size standard is not dominant in its field of operation.

(c) Please address any requests to change existing size standards or establish new ones for emerging industries to the Assistant Administrator for Size Standards, Small Business Administration, 409 3rd Street, SW., Washington, DC 20416.

§ 121.103 What is affiliation?

(a) *General Principles of Affiliation.* (1) Concerns are affiliates of each other when one concern controls or has the power to control the other, or a third party or parties controls or has the power to control both.

(2) SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships, in determining whether affiliation exists.

(3) Individuals or firms that have identical or substantially identical business or economic interests, such as family members, persons with common investments, or firms that are economically dependent through contractual or other relationships, may be treated as one party with such interests aggregated.

(4) SBA counts the receipts or employees of the concern whose size is at issue and those of all its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit, in determining the concern's size.

(b) *Exclusion from affiliation coverage.* (1) Business concerns owned in whole or substantial part by investment companies licensed, or development companies qualifying, under the Small Business Investment Act of 1958, as amended, are not considered affiliates of such investment companies or development companies.

(2) Business concerns owned and controlled by Indian Tribes, Alaska Regional or Village Corporations organized pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. 1601), Native Hawaiian Organizations, or Community Development Corporations authorized by 42 U.S.C. 9805 are not considered affiliates of such entities, or with other concerns owned by these entities solely because of their common ownership.

(3) Business concerns which are part of an SBA approved pool of concerns for a joint program of research and development as authorized by the Small Business Act are not affiliates of one another because of the pool.

(4) Business concerns which lease employees from concerns primarily engaged in leasing employees to other businesses are not affiliated with the leasing company solely on the basis of a leasing agreement.

(5) For financial, management or technical assistance under the Small Business Investment Company program, an applicant concern is not affiliated with the investors listed in paragraphs (b)(5)(i) through (vi) of this section if the investors do not control the concern except under those circumstances set forth in §107.865(c) or (d) of this chapter. For purposes of this paragraph (b)(5), "control" is determined under §107.865 of this chapter.

(i) Venture capital operating companies, as defined in the U.S. Department of Labor regulations found at 29 CFR 2510.3–101(d);

(ii) Employee benefit or pension plans established and maintained by

the Federal government or any state, or their political subdivisions, or any agency or instrumentality thereof, for the benefit of employees;

(iii) Employee benefit or pension plans within the meaning of the Employee Retirement Income Security Act of 1974, as amended (29 U.S.C. 1001, *et seq.*);

(iv) Charitable trusts, foundations, endowments, or similar organizations exempt from Federal income taxation under section 501(c) of the Internal Revenue Code of 1986, as amended (26 U.S.C. 501(c));

(v) Investment companies registered under the Investment Company Act of 1940, as amended (1940 Act) (15 U.S.C. 80a-1, *et seq.*); and

(vi) Investment companies, as defined under the 1940 Act, which are not registered under the 1940 Act because they are beneficially owned by less than 100 persons, if the company's sales literature or organizational documents indicate that its principal purpose is investment in securities rather than the operation of commercial enterprises.

(6) A protege firm is not an affiliate of a mentor firm solely because the protege firm receives assistance from the mentor firm under Federal Mentor-Protege programs.

(c) *Affiliation based on stock ownership.* (1) A person is an affiliate of a concern if the person owns or controls, or has the power to control 50 percent or more of its voting stock, or a block of stock which affords control because it is large compared to other outstanding blocks of stock.

(2) If two or more persons each owns, controls or has the power to control less than 50 percent of the voting stock of a concern, with minority holdings that are equal or approximately equal in size, but the aggregate of these minority holdings is large as compared with any other stock holding, each such person is presumed to be an affiliate of the concern.

(d) *Affiliation arising under stock options, convertible debentures, and agreements to merge.* Since stock options, convertible debentures, and agreements to merge (including agreements in principle) affect the power to control a concern, SBA treats them as though the rights granted have been exercised (except that an affiliate cannot use them to appear to terminate control over another concern before it actually does so). SBA gives present effect to an agreement to merge or sell stock whether such agreement is unconditional, conditional, or finalized but unexecuted. Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered "agreements in principle" and, thus, are not given present effect.

(e) *Affiliation based on common management.* Affiliation arises where one or more officers, directors or general partners controls the board of directors and/or the management of another concern.

(f) *Affiliation based on joint venture arrangements.* (1) Parties to a joint venture are affiliates if any one of them seeks SBA financial assistance for use in connection with the joint venture.

(2) Concerns bidding on a particular procurement or property sale as joint venturers are affiliated with each other with regard to performance of that contract.

(3) A contractor and subcontractor are treated as joint venturers if the ostensible subcontractor will perform primary and vital requirements of a contract or if the prime contractor is unusually reliant upon the ostensible subcontractor. All requirements of the contract are considered in reviewing such relationship, including contract management, technical responsibilities, and the percentage of subcontracted work.

(4) For size purposes, a concern must include in its revenues its proportionate share of joint venture receipts.

(g) *Affiliation based on franchise and license agreements.* The restraints imposed on a franchisee or licensee by its franchise or license agreement relating to standardized quality, advertising, accounting format and other similar provisions, generally will not be considered in determining whether the franchisor or licensor is affiliated with the franchisee or licensee provided the franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership. Affiliation may arise, however,

through other means, such as common ownership, common management or excessive restrictions upon the sale of the franchise interest.

§ 121.104 How does SBA calculate annual receipts?

(a) *Definitions.* In determining annual receipts of a concern:

(1) *Receipts* means "total income" (or in the case of a sole proprietorship, "gross income") plus the "cost of goods sold" as these terms are defined or reported on Internal Revenue Service (IRS) Federal tax return forms (Form 1120 for corporations; Form 1120S for Subchapter S corporations; Form 1065 for partnerships; and Form 1040, Schedule F for farm or Schedule C for other sole proprietorships). However, the term receipts excludes net capital gains or losses, taxes collected for and remitted to a taxing authority if included in gross or total income, proceeds from the transactions between a concern and its domestic or foreign affiliates (if also excluded from gross or total income on a consolidated return filed with the IRS), and amounts collected for another by a travel agent, real estate agent, advertising agent, or conference management service provider.

(2) *Completed fiscal year* means a taxable year including any short period. Taxable year and short period have the meaning attributed to them by the IRS.

(3) Unless otherwise defined in this section, all terms shall have the meaning attributed to them by the IRS.

(b) *Period of measurement.* (1) Annual receipts of a concern which has been in business for 3 or more completed fiscal years means the receipts of the concern over its last 3 completed fiscal years divided by three.

(2) Annual receipts of a concern which has been in business for less than 3 complete fiscal years means the receipts for the period the concern has been in business divided by the number of weeks in business, multiplied by 52.

(3) Annual receipts of a concern which has been in business 3 or more complete fiscal years but has a short year as one of those years means the receipts for the short year and the two full fiscal years divided by the number of weeks in the short year and the two full fiscal years, multiplied by 52.

(c) *Use of information other than the Federal tax return.* Where other information gives SBA reason to regard Federal Income Tax returns as false, SBA may base its size determination on such other information.

(d) *Annual receipts of affiliates.* (1) If a concern has acquired an affiliate or been acquired as an affiliate during the applicable averaging period or before small business self-certification, the annual receipts in determining size status include the receipts of both firms. Furthermore, this aggregation applies for the entire applicable period used in computing size rather than only for the period after the affiliation arose. Receipts are determined for the concern and its affiliates in accordance with paragraph (b) of this section even though this may result in different periods being used to calculate annual receipts.

(2) The annual receipts of a former affiliate are not included as annual receipts if affiliation ceased before the date used for determining size. This exclusion of annual receipts of a former affiliate applies during the entire period used in computing size, rather than only for the period after which the affiliation ceased .

§ 121.105 How does SBA define "business concern or concern"?

(a) A business concern eligible for assistance from SBA as a small business is a business entity organized for profit, with a place of business located in the United States, and which operates primarily within the United States or which makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor.

(b) A business concern may be in the legal form of an individual proprietorship, partnership, limited liability company, corporation, joint venture, association, trust or cooperative, except that where the form is a joint venture there can be no more than 49 percent participation by foreign business entities in the joint venture.

(c) A firm will not be treated as a separate business concern if a substantial portion of its assets and/or liabil-

EXHIBIT B

Small Business Administration
Regulation Excerpt

13 C.F.R. § 107.865

(1) The fee is no more than 2 percent of the Financing amount (or, if two or more Licensees participate in the Financing, their combined closing fees are no more than 2 percent of the total Financing amount); and

(2) You charge the fee no earlier than the date of the first disbursement.

(d) *Closing fee—Debt or Equity Financings.* You may charge a Closing Fee on a Debt Security or Equity Security Financing if:

(1) The fee is no more than 4 percent of the Financing amount (or, if two or more Licensees participate in the Financing, their combined closing fees are no more than 4 percent of the total Financing amount); and

(2) You charge the fee no earlier than the date of the first disbursement.

(e) *Limitation on dual fees.* If another Licensee or an Associate of yours collects a transaction fee under § 107.900(e) in connection with your Financing of a Small Business, the sum of the transaction fee and your application and closing fees cannot exceed the maximum application and closing fees permitted under this § 107.860.

(f) *Expense reimbursements.* You may charge a Small Business for the reasonable out-of-pocket expenses, other than Management Expenses, that you incur to process its Financing application. If SBA determines that any of your reimbursed expenses are unreasonable or are Management Expenses, SBA will require you to include such amounts in the Cost of Money or refund them to the Small Business.

(g) *Breakup fee.* If a Small Business accepts your Commitment and then fails to close the Financing because it has accepted funds from another source, you may charge a "breakup fee" equal to the closing fee that you would have been permitted to charge under paragraph (c) or (d) of this section.

§ 107.865 Restrictions on Control of a Small Business by a Licensee.

(a) *General.* You must not operate a business enterprise or function as a holding company exercising Control over a business enterprise. Neither you, nor you and your Associates, nor you and other Licensee(s) (in the latter two cases, the "Investor Group") may, except as set forth in this section, assume Control over a Small Business through management agreements, voting trusts, majority representation on the board of directors, or otherwise.

(b) *Presumption of Control.* Control over a Small Business will be presumed to exist whenever you or the Investor Group own or control, directly or indirectly:

(1) At least 50 percent of the outstanding voting securities, if there are fewer than 50 shareholders; or

(2) More than 25 percent of the outstanding voting securities, if there are 50 or more shareholders; or

(3) A block of at least 20 percent of the outstanding voting securities, if there are 50 or more shareholders and no other party holds a larger block.

(c) *Rebuttals to presumption of Control.* A presumption of Control under paragraph (b) of this section is rebutted if:

(1) The management of the Small Business owns at least a 25 percent interest in the voting securities of the business; and

(2) The management of the Small Business can elect at least 40 percent (rounded down) of the board members of a corporation, general partners of a limited partnership, or managers of a limited liability company, as appropriate, and the Investor Group can elect no more than 40 percent (rounded up). The balance of such officials may be elected through mutual agreement by management and the Investor Group.

(d) *Temporary Control permitted.* You may acquire temporary Control:

(1) Where reasonably necessary for the protection of your investment;

(2) If there has been a material breach of the Financing agreement by the Small Business;

(3) If there has been a substantial change in the Small Business's operations or products during the past 2 years, or such a change is the intended result of the Financing, and the Investor Group's Financing constitutes the Small Business's major source of capital; or

(4) In the case of a Start-up Financing, if you or the Investor Group constitute the Small Business's major source of capital.

(e) *Control certification.* If you take temporary Control of a Small Business under paragraph (d) of this section, you must file a Control certification with SBA within 30 days. The certification must state:

(1) The date on which you took Control;

(2) The basis for taking Control; and

(3) Your agreement to relinquish Control within five years (although you may, under extraordinary circumstances, request SBA's approval of an extension beyond five years).

(f) *Control acquired through enforcement actions.* If you retain or acquire Control through enforcement action, you must notify SBA immediately and submit a Control certification within 30 days.

(g) *Additional Financing for businesses under Licensee's Control.* If you assume Control of a Small Business, you may later provide additional Financing, without an exemption under § 107.730(a)(1).

§ 107.880 Assets acquired in liquidation of Portfolio securities.

You may acquire assets in full or partial liquidation of a Small Business's obligation to you under the conditions permitted by this § 107.880. The assets may be acquired from the Small Business, a guarantor of its obligation, or another party.

(a) *Timely disposition of assets.* You must dispose of assets acquired in liquidation of a Portfolio security within a reasonable period of time.

(b) *Permitted expenditures to preserve assets.* (1) You may incur reasonably necessary expenditures to maintain and preserve assets acquired.

(2) You may incur reasonably necessary expenditures for improvements to render such assets saleable.

(3) You may make payments of mortgage principal and interest (including amounts in arrears when you acquired the asset), pay taxes when due, and pay for necessary insurance coverage.

(c) *SBA approval of expenditures.* This paragraph (c) applies if you have outstanding Leverage or are applying for Leverage. Any application for SBA approval under this paragraph must specify all expenses estimated to be necessary pending disposal of the assets. Without SBA's prior written approval:

(1) Your total expenditures under paragraphs (b)(1) and (b)(2) of this section plus your total Financing(s) to the Small Business must not exceed your overline limit under § 107.740; and

(2) Your total expenditures under paragraph (b) of this section plus your total Financing(s) to the Small Business must not exceed 35 percent of your Regulatory Capital.

Limitations on Disposition of Assets

§ 107.885 Disposition of assets to Licensee's Associates or to competitors of Portfolio Concern.

(a) *Sale of assets to Associate.* Except with SBA's prior written approval, you are not permitted to dispose of assets (including assets acquired in liquidation) to any Associate if you have outstanding Leverage or Earmarked Assets. As a prerequisite to such approval, you must demonstrate that the proposed terms of disposal are at least as favorable to you as the terms obtainable elsewhere.

(b) *Sale of assets to competitor of Small Business.* Except with the prior written approval of the Portfolio Concern (if it is not under your Control) or of SBA, you are not permitted to dispose of Portfolio securities to a competitor of such concern. If SBA's prior approval is not required, you must promptly notify SBA of any such disposal.

Management Services and Fees

§ 107.900 Management fees for services provided to a Small Business by Licensee or its Associate.

This § 107.900 applies to management services that you or your Associate provide to a Small Business during the term of a Financing or prior to Financing. It does not apply to management services that you or your Associate provide to a Small Business that you do not finance. Fees permitted under this section are not included in the Cost of Money (see § 107.855).

(a) *Permitted management fees.* You or your Associate may provide management services to a Small Business financed by you if:

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CERTIFICATE OF SERVICE

I, Carol L. Malmud, certify that a copy of the foregoing Ex Parte Supplement Regarding Affiliation Standards by the Small Cable Business Association was served on this 11th day of October, 1996, by first-class, U.S. Mail, postage prepaid, to the following persons on the attached list:

Carol L. Malmud

Carol L. Malmud

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Washington, DC 20554

Commissioner James H. Quello
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